GIPSA Livestock and Meat Marketing Study Comments
Des Moines, Iowa and Kansas City, Missouri

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Introduction

The United States Department of Agriculture's Grain Inspection Packers and Stockyards Administration (GIPSA) has released the GIPSA Livestock and Meat Market Study. GIPSA contracted with RTI International (RTI) to conduct this study on the use and impacts of marketing arrangements in the livestock and meat industries. The study was mandated by Congress in 2003 to assess the effects on the market of packer ownership of livestock more than 14 days in advance of slaughter, and to examine alternative methods of procuring and transferring livestock from farm to retail.

RTI conducted extensive analyses of the economic effects of alternative marketing arrangements (AMAs) on beef, pork, and lamb marketing channels. AMAs are methods by which livestock and meat are transferred through successive stages of production and marketing, and include forward contracting, packer ownership, and marketing agreements.

The final report: (1) addresses the extent of AMA's use; (2) analyzes price differences and short-run market price effects of AMAs; (3) measures and compares costs and benefits associated with spot or negotiated marketing arrangements and AMAs; and (4) analyzes the implications of AMAs for the livestock and meat marketing system.

Overall, the report found that alternative marketing arrangements (AMAs) increase the economic efficiency of the cattle, hog, and lamb markets, and that these efficiencies yield economic benefits to consumers, as well as to producers and packers who use AMAs.

Specific study highlights organized by the four topics above include:

Extent of Alternative Marketing Arrangement Use

- AMA use is estimated at 38 percent of the volume for fed cattle, 89 percent of the volume of finished hogs, and 44 percent of the volume for fed lambs. Packer ownership volumes are less than 5 percent for fed cattle and fed lambs and 20 to 30 percent for finished hogs, depending on how hogs under production contracts are treated.

- Most packers and many producers use portfolios of marketing arrangements rather than a single type to manage marketing and procurement risks.

Price differences and short-run market price effects of AMAs

- Prices for fed cattle (when controlling for differences in quality and seasonality) are similar for the cash market and marketing agreements, higher for the small percentage of auction barn cattle compared to the cash market, and lower for the small percentage of forward contract cattle compared to the cash market.

- Prices for finished hogs (controlling for differences in quality and seasonality) are higher for marketing contracts and lower for packer-owned hogs relative to the cash market.

- The stability of fed-cattle cash-market prices to a 10 percent increase in the volume traded in AMAs is relatively strong, that is, a 10 percent AMA volume increase results in a 0.1 percent decrease in the cash market price.

- Looking at the stability of the hog cash market, a 1 percent increase in hogs under contract is associated with almost a 1 percent decrease in cash market prices and a 1 percent increase in hogs under packer ownership is associated with a 0.3 percent decrease in cash market prices. These stability measures do not necessarily imply producers would be better off with AMA restrictions, because reductions in AMAs would divert some supplies into the cash market and likely cause an offsetting decline in the cash market price, with net adverse affects on producers as described below.

Measurement and comparison of costs and benefits for the cash market and AMAs

- In cattle slaughter, procurement of cattle through AMAs is associated with lower average production costs per head for the overall industry than procurement through cash markets, but this result does not hold for all plants. The estimated industry average cost savings is $6.50 per head when using AMAs for an average processing cost of about $138 per head during the period covered by the study.

- In hog slaughter, procurement of hogs through AMAs is associated with an extremely small decrease in productions costs. A 1 percent increase in AMA use is associated with an extremely small decrease in marginal costs at the sample means (because AMA use is already extremely high).

- In the beef industry, cattle sold through marketing agreements are generally higher quality and have less variation in quality than cattle sold through the cash market. The increase in quality for marketing agreement cattle relative to direct trade cattle is equivalent to a 57 cent per hundredweight increase in value.

- In the pork industry, hogs sold through marketing contracts are generally higher quality than hogs sold through the cash market. These hogs rank higher across multiple quality measures (such as average lean percentage, loin-eye area, and average loin depth).

- Across all species, AMAs offer some guarantee of market access, for both livestock producers and meat packers. That is, AMAs ensure that producers can sell livestock and meat packers can purchase livestock when they need to. This allows for more uniform and greater utilization of facility capacities in both production and processing sectors.

- In the beef industry, the variance of prices for marketing agreement cattle is 18 to 20 percent less than for cash market cattle when controlling for differences in quality.

- In the pork industry, the variance of prices for hogs sold through marketing contracts is 5 to 45 percent less than for hogs sold through the cash market (but not controlled for differences in quality). Also, use of production contracts for hog producers eliminates about 94 percent of the producer income volatility compared to independent hog producers.

- The results of the lamb industry analyses were relatively similar to the results for the beef industry described above with a couple of notable differences. Prices of fed lambs sold on the cash market are slightly higher than other methods, and use of AMAs does not appear to reduce price risk. However, procurement of lambs through AMAs is associated with lower production costs and higher quality.

Implications of AMAs for the livestock and meat marketing system

Use of AMAs in the livestock and meat industries provide benefits not only to meat packers but also to livestock producers and meat consumers. Restricting their use would have negative economic consequences on most segments of the industry.

- In the beef industry, over 10 years, eliminating AMAs would reduce economic surplus to livestock producers and feeders, beef packers, and consumers by 5 to 16 percent for each sector of the industry.

- In the pork industry, limitations on AMAs in order to increase the cash market share from its current 11 percent to 25 percent over a period of 10 years would reduce economic surplus by 3 to 5 percent for hog producers and pork consumers, but slightly increase economic surplus for pork packers.

Across the scenarios analyzed, livestock producers would have greater economic losses due to restrictions than packers. The cash market serves an important role in the industry for price discovery and in particular for smaller producers and packers. Cash market prices are also frequently used as the base for formula pricing under AMAs and are important for marketing arrangements using formula pricing. As long as prices are reported for different types of marketing arrangements—current USDA price reporting—base prices reflect expected supply-demand conditions. While in the aggregate AMAs are given a good bill of health, the measurements of the stability of the respective cash market price indicate its sensitivity to volume changes and the need for monitoring and enforcement of the Packers and Stockyards Act to identify individual instances when AMA use is associated with a violation of the Packers and Stockyards Act.